IT 01-0013-GIL 02/15/2001 CREDITS – FOREIGN TAX

> General Information Letter: In the case of an Illinois resident individual, only income from California sources is actually taxed by California. The limitation on the foreign tax credit allowed cannot be computed using income from all sources used by California to determine the rate of tax imposed.

February 15, 2001

Dear:

This is in response to your letter dated January 29, 2001, in which you request a letter ruling. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. *See* 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.revenue.state.il.us.

In your letter you have stated the following:

> In mid-December I spoke with an Illinois Revenue Tax Specialist over the telephone regarding the LTR-402 Error Notice Response we received for the above named client. Per the response in the notice, Illinois did not agree with the way we calculated the credit for taxes paid to other states on the Schedule CR (specifically line 2, column B, Illinois base income taxed by other state). We calculated this credit based on the Illinois instructions for this line which state "for each state listed in Column A, enter the amount of income subject to that state's tax that is included in Illinois base income". We interpret that to mean the amount of income that is subject to that tax in the other state. However, per our phone conversation, I was instructed that the case was reviewed with a supervisor who used Illinois Revenue guidelines which state that this is the adjusted gross income in the other state – not the taxable income in the other state.
>
> Please send us documentation clarifying this issue, as the Illinois instructions apparently do not agree with the Illinois Revenue Guidelines.

Response

Section 601(b)(3) of the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 *et seq.*) provides that:

> The aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to the tax imposed by subsections 201(a) and (b) of this Act shall be credited against the tax imposed by subsections 201(a) and (b) otherwise due under this Act for such taxable year. The aggregate credit provided under this paragraph shall not exceed that amount which bears the same ratio to the tax imposed by subsections 201(a) and (b) otherwise due under this Act as the amount of the taxpayer's base income subject to tax both by such other state or states and by this State bears to his total base income subject to tax by this State for the taxable year.

I have reviewed the 1999 Form IL-1040, including the Schedule CR and attachments, filed by your client. The issue concerns the meaning of the term "income subject to tax" by both California and Illinois.

As you are aware, California income tax for a nonresident is computed by applying the tax rates to all of the income from all sources of the nonresident, in the same manner as a resident would determine his or her tax, and then multiplying the tax so determined by a fraction equal to the nonresident's California source income divided by his or her total income. Your client is claiming that her total income from all sources is subject to California income tax. The California Board of Equalization has repeatedly denied that, by computing the tax in this manner, California income tax is imposed on income from non-California sources.

Moreover, New York computes its income tax on nonresidents in the same manner as does California. In the context of computing the credit allowed for taxes paid to New York, the courts have unanimously held that "income subject to tax" by New York includes only income sourced to that state. *See Chin v. Director,* 14 N.J. Tax 304 (1994); *Comptroller v. Hickey,* 689 A.2d 1316 (Md. Ct. Sp. App. 1997); *Tucker v. Arizona Dept. of Revenue*, Docket No. 1755-98-I (Arizona State Board of Tax Appeals, December 1, 1998). The Illinois Department of Revenue has ruled on this issue in the context of Maine income tax in Letter Ruling IT 87-0253 (October 8, 1987).

Accordingly, in computing the limitation on the credit allowed under Section 601(b)(3) of the IITA, only income from California sources is considered "income subject to tax" by California.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton
Deputy General Counsel -- Income Tax